Anarchy and the Law: The Political Economy of Choice by Edward Stringham

Excerpt from "Anarchy and the Law"....  I have now described anarcho-capitalism as I believe it would function in a modern society. What are Cowen's reasons for believing that such institutions would be unstable? Cown (1992) writes:

> ...the argument is that Friedman's scenario is not an independent alternative. Competing law codes are stable only if they evolve into a dominant agency or arbitration network... Agencies might eschew warfare in favor of arbitration and interagency cooperation. Agencies would agree in advance how interagency conflicts will be settled. Common standards would be applied for criminality, punishment, and criminal procedures when disputes occur.... A systematic arbitration network would arise to encourage the orderly application of law. Although intra-agency conflicts might be settled differently from interagency conflicts,society would possess effectively a single legal code....At the very least,agencies abide by higher-order arbitration....

So far I agree with Cowen, provided that the accent is put on the final sentence and that it is recognized that what is described is an equilibrium, not a constraint. Firms almost always abide by arbitration because it is almost always in their interest to do so. Describing this as a single legal code is, however, somewhat misleading, since there may be as many legal codes as there are pairs of agencies. The distinction between a market equilibrium and a constraint is not merely a verbal one. Consider the analogous case of an ordinary competitive market. Economic theory tells us that firms selling identical goods will all charge the same price. That does not mean that firms are not free to change their price if they wish, nor that a change by one firm will somehow force every other firm to make an identical change. On the contrary, the analysis of what the price will be depends on the assumption that each firm is free to set whatever price it wishes, and deduces both the existence and level of the common price from that assumption. Similarly, protection firms under anarcho-capitalism will agree on arbitrators to settle disputes between them, but that is a consequence of their profit maximizing behavior, not a constraint upon it. The fact that they are free to refuse to agree to arbitration is one of the

elements that determine what the actual terms of arbitration will be. Cowen then writes:

> Unlike Nozick's ultraminimal state, the network consists of more than one firm....The presence of a network gives rise to contractual relations that induce firms to behave cooperatively, as if they were one large firm. Whether the common arbitration network is "one big firm," or "many cooperating smaller firms" is primarily a matter of semantics. The network can just as well be considered a single firm with separate divisions that compete to some degree. Each division has its own set of residual claimants, but the behavior of divisions is constrained to favor the interests of the entire network.

So far as I can tell, this final assertion is nowhere justified, and I believe it to be false. What Cowen describes as a "network" is simply a set of private firms-protection and arbitration agencies-linked by a large number of contracts. Each pair of protection agencies has a contract specifying an arbitrator for disputes between their customers, and each protection agency has contracts with one or more arbitration agencies specifying the terms on which they will arbitrate its disputes wiht specified other protection agencies. Nothing in this situation requires or implies a single firm controlling the whole, nor anything analogous to one. The network as I have described it has no decision-making body. It's "decisions," the set of legal codes it enforces, are the outcome of independent profit-making decisions by the individual firms and bargaining between pairs of firms. Nothing in the logic of the market for protection and arbitration implies that the outcome will maximize the summed profits of the firms,as Cowen seems to assert. Indeed, ordinary economic theory suggests that in equilibrium this market, like any competitive market, will yield zero profit to the firms that make it up. Consider Cowen's argument applied to a less exotic industry-groceries. As a practical matter, any grocery that wishes to stay in business much have contracts with a number of large suppliers, such as Kraft and General Mills, either directly or through distributors that function as intermediaries. Thus all grocery stores are linked together by contracts with common intermediaries. The whole collection of firms-grocery stores,producers,wholesalers-could be described as a network in the same sense in which Cowen describes the protection agency as a network. Does it follow that, in the grocery industry, "contractual relations...induce firms to behave cooperatively, as if they were one large firm?" Is there any reason to believe that the behavior of the separate firms "is constrained to favor the interests of the entire network?" Grocery stores and protection agencies are indeed constrained, but it is not their own interest that they are constrained to follow. Grocery stores are constrained to follow policies that maximize the welfare of their customers, and protection agencies are constrained to enforce legal codes that maximize the welfare of their customers, for essentially analogous reasons. In both cases the constraint is only approximate, due to the familiar problems of imperfect competition, imperfect knowledge, externalities, and the like. But nothing in the logic of either market leads to maximization of the interests of the industry. Anarchy and the Law by Edward Stringham... found here and here